Economic and Geo-Political Prognosis for 2015

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Abstract:

The re-moderation of the world economy set in place over the past few years continues apace. Notwithstanding some lasting damage on the supply side through the 2008 recessionary trough, our outlook for 2015 is bullish weighing more on optimistic data trends than on continued negative sentiment proffered from some analyst quarters.

Around the world in 80 (or more) words:

Treating the ten-year US Treasury bond yield as a proxy indicator for that nation's nominal GDP growth, we anticipate United States to grow around 3% next year.[1] While this does not mark a return to the buoyant 90s, it is better than the secular stagnation hypothesized earlier in 2014.[2] With US acting as an engine to spur growth, the world economy should also expand by more than 3%.[3] Stability across the world will be maintained – as sparks without a concomitant fury will characterize both overt (e.g. Russia-West over Ukraine) and covert (e.g. China-Japan over Senkaku) animosities.[4] European stagnation from debt and unemployment will be counterbalanced through quantitative easing by the European Central Bank.[5] Similar action in Japan will display the limits of Abe-nomics.[6] China will prepare for a structural slowdown emphasizing domestic consumption and de-leveraging an over-heated financial sector; all the while growing at a 7% rate that will amaze rivals around the world.[7] Indian reform, even if inadequate, will boost the middle classes and reinforce confidence in the Modi government.[8] African countries will find their commodity boom dissipate and ease of borrowing decline as commodity prices fall and yields rise in the developed world.[9]
Continental tectonics:

a. North America:

Economic benefits arising from the exploitation of shale gas have not only silenced the anti-fracking environmentalists, they have altered the strategic world-view of Washington politicians.[10] As US aims to overtake even Saudi Arabia in oil/NGL production in 2015 (and the Saudis pull out all stops in preventing it by driving crude prices down), it has markedly reduced its role as a global policeman.[11] Its own economy is on the mend even as a lame-duck president will be boggled down with partisan grid-lock. Markets will fret about the mid-year (or earlier?) hike in interest rates; though Main Street - aided by a strong dollar - will likely shrug it off with a continued upward movement across different sectors.[12]

Mexico and Canada will benefit from their tight coupling with the United States.[13] Enrique Pena Nieto will claim credit for reforming the Mexican economy – across sectors as diverse as energy and telecom.[14] Pemex, dear to the Mexicans, will face some competition, though nothing remotely similar to the American acquisition of Tim Hortons – dear to the Canadians – will happen.[15] Up north, the Canadian elections in 2015 will reveal whether the country has reverted to its liberal propensities or sticks with Harper’s conservative agenda.[16]

b. Latin and South America:

The outlook is disappointing across much of the region. Run-away inflation hammers Argentina and Venezuela; milder ill-effects bedevil Brazil, Bolivia and Uruguay.[17] The Maduro regime in Venezuela and the Kirchner government in Argentina continue to flirt with disaster as their GDP growths slip and mass discontent builds up.[18] Dilma Rousseff has stabilized her position electorally, though her policies continue to disappoint investors and have the potential to reignite sudden protests like the 2013 bus-fare protests.[19] Dependence on commodity exports in a time of declining prices does not portend well for any of the South American states, including Brazil.[20] On a positive note, Cuba – already expected by analysts to grow by close to 4% next year – will see a boost to its fortunes accruing from a thaw in relations with US under Obama.[21]

c. Africa:

African nations had a great run in the past few years. This arose not only from the boom in commodity prices but also from the need for yield amongst DM (developed market) investors resulting in investment in both corporate and public African bonds.[22] In 2015, these factors could dissipate which will place pressure on countries like Angola where household spending has risen more than 4000% since the start of the millennium.[23] Ethiopia and Kenya are expected to continue on a robust growth path.[24] Contradictions abound within Africa, and nowhere are they more visible than in Nigeria. While the northern part struggles under the oppression of Boko Haram, the southern part booms under Goodluck Jonathan’s president-ship.[25] In neighboring South Sudan, one is reminded of the risk-reward payoff as the nation widely tipped to experience spectacular growth in 2014, got mired in conflict, with the consequent dissipation of growth potential.
American intervention in Libya undermined the Gaddafi-imposed order and has led to a civil war between the Islamist and secularist factions which will hold back that nation in the coming year.[27] A more benign intervention was that of the French in Mali in 2013; we expect more calls for Hollande’s assistance in 2015.[28] El Sisi has stabilized Egypt after the Muslim Brotherhood interlude in the post-Mubarak era. Though more brutal than Mubarak, the El Sisi regime is being propped by both the Americans and Saudis, leading us to expect the recent bull run in Egyptian markets to continue.[29] ANC rule in South Africa continues unimpeded. Though atrophied by many scandals, the rule should produce close to 3% growth in the coming year.[30]

d. Middle East:

The region continues to be a cesspool of ethno-sectarian rivalries as the century-old Sykes-Pikot agreement unravels.[31] Recep Erdogan has stabilized Turkey and should reap a growth on par with other emerging economies.[32] Erdogan’s external actions driven by AKP’s crypto-desire to establish a caliphate will see him prop the Islamic State (IS) just so that it can damage Shia and Kurdish interests; but not enough to threaten his own Sunni hegemonic plans.[33] The Saudi establishment has focused on the removal of the Muslim brotherhood threat; now they will focus on limiting Shia Iranian influence by keeping crude prices low.[34] Western companies made a beeline to Iran in 2014 in hope of an impending thaw; much will depend on the negotiation ability of the Rouhani establishment on the sanction front.[35] Dubai and Israel remain insulated from the turmoil around and could reap the benefit of the uptick in the world economy.[36] The risk of sudden flare-ups like the 2014 Gaza war continue to remain on the Israeli radar.

e. Asia and Australia:

The Asian political scene is remarkably stable with China, Japan and India looking inward to stabilize their economies under the leadership of Xi Jinping, Shinzo Abe and Narendra Modi, respectively. Some events have gone unnoticed by world media – for example, China starts the year of the goat as the world’s largest economy when measured in PPP terms and for the first time ever, Chinese outbound investments could exceed those inbound.[37] The establishment of China on the world stage has made Xi stronger than any Chinese leader in recent memory bar Chairman Mao himself. The Abe regime will continue on its reformist route of bringing Japan out of the deflationary zone, while winking at nationalist sentiment calling for a re-interpretation of the country’s post-war pacifist role.[38] Down south in India, Modi has surprised both supporters and detractors alike by his middle-path approach to reforming the economy and his zealous interest in foreign policy. While reforming cautiously, he has not removed the populist schemes of the previous government. 2015 will see him act unimpeded by local elections (other than in Bihar) and will prove to be a litmus test of his claims of good governance.[39]

Afghanistan under Ashraf Ghani will face more trouble from Taliban as US adopts the Pakistani classification into good versus bad Taliban.[40] In nearby Pakistan, the wildly popular Imran Khan - with some help, perhaps, from the deep state – will challenge the established parties in their home turfs.[41] In Indonesia, Jake Widodo has come to power with Imran Khan-type support amongst the youth, and he will be hard-pressed to implement his reformist agenda – including reducing fuel subsidies – amidst persistent opposition from entrenched interests.
ASEAN will continue to slip on its stated intentions for closer cooperation. Australia will try to balance its strategic partnership with the United States with economic dalliances with the Chinese.

Europe and Russia:

Vladimir Putin will be emboldened by the short-term rise in domestic popularity; and hence ignore the longer-term implications of his intervention in Ukraine. Tighter coupling with Kazakhstan and Belarus will not prevent what is likely to be a low-growth and high-inflation year for the Russians. Europe as a whole continues to underperform, and it will be most visible in France and Italy both of whom might record less than 1% growth in GDP. With the Trierweller-Gayet saga behind his back, Francois Hollande will attempt to rein in a deficit running at close to 4% of GDP. Even with help from ECB's quantitative easing program, there is little expectation that Hollande can avoid being the most unpopular leader amongst all western democracies. In Italy, high debt and unemployment – exemplified by the statistic of four-fifths of Italians between the ages of 20-31 living with parents – will hamper any efforts Matteo Renzi might take to pull the economy out of its doldrums.

The Greeks might look forward to a better year, especially when juxtaposed against their recent past. On the back of painful reforms, the Greek economy is widely anticipated to commence its long journey back to health, though there might be recurrent political scares and recalcitrant rumors of a Greek exit. The German government will be buffeted by opposing demands – external calls for a more interventionist role in stabilizing the world economy and internal ones for tempering the same. Cautious progress on the fiscal front will lead to modest GDP growth. Ironcally, the European nations with best GDP growth projections are also the ones with the highest exposure to Putin's misadventures, viz. Poland, Latvia and Lithuania.

Sectors and segments:

Having dropped significantly in the past few months, the level of oil prices affects the prospects for many industry sectors in 2015. Oil is typically expected to revert to the mean because a lower oil price has discernible impact on both supply (by discouraging investment in its production and distribution) and demand (by boosting economic activity) sides. The speed of such mean-reversion remains unclear. Russia, Iran and US shale producers (esp. those who are not based at strategic locations) suffer disproportionally more than the Saudi establishment at current price levels. Lower oil prices will provide a fillip to consumer discretionary industries and airlines; and have an adverse impact on railroad (benefiting from oil transportation) and petrochemical companies. The shale gas boom - apart from increasing housing activity - is also the prime driver behind growth in the US steel and construction material sectors; consequently both the steel and construction sectors will remain susceptible to crude movements.

Low interest rates and low macro-growth prospects will induce companies with excess cash to acquire other companies to report earnings growth. That trend will be apparent in companies transacting in sectors as diverse as healthcare, industrials, semiconductors, software and materials. On another side of investment banks, trading desks will see higher market volatility as major powers pursue divergent paths to monetary policy (e.g. US against EU/Japan).
In US, regulatory obligations increasing cost of capital for holding certain securities might lead to decreased broker liquidity. 2015 shall see the big banks grapple with the regulations in Basel III and Volcker; one expects regulatory push towards vanilla deposit-taking and lending to continue. Analysts will hope that stronger balance sheets coupled with a return to profitability lead to increased dividend payout for investors in financial stocks. China will seek to tame its overheated financial sector amidst a structural slowdown, and India will see RBI governor Raghuram Rajan continue his battle against political interference in corporate lending. Wealth management services will perform remarkably well not only in China, but also to a lesser extent in US as a rising market creates wealth and a retiring baby-boomer crowd seeks to couple low risk with acceptable return. In the arena of mobile payment, Apple Pay will try to avoid the lackluster performance of earlier attempts like Google Wallet.

Lower gasoline prices and an accompanying increase in disposable income (through wealth creation at the markets, increased home values, reduced unemployment and improved economic activity) creates a positive outlook for the consumer discretionary sector. Companies dealing with organic farming benefit from increased health consciousness; the market for yoga will continue to rise as 2014 saw the UN declare a world yoga day on Modi’s initiative. Even as DVDs and Blue-rays fall, digital film subscriptions and on-demand internet steaming will rise to please Hollywood. Bollywood will get over its obsession with INR 100 crore revenues as movies will cross that level more frequently. With supply level of hotels remaining the same as few years back, revenue per room will rise across the sector. Tighter access to credit continues to hamper the rise in existing house sales, which nevertheless should improve over the past year. Asian apparel manufacturers continue to improve their market share in the fast fashion market. October 2015 will see Europeans benefit from the eCall service in all their new cars, which allows a car to immediately report details to the base-stations on any accident. New carbon-emission standards also come into force in Europe; even elsewhere the move towards higher efficiency in cars will continue. Widodo will be pleased at the growth in automobile sales in Indonesia, which should exceed those of other major markets. Internet advertising is rising faster than television commercials, though 2015 will still see the latter dominate the former in overall revenue generated. Privacy concerns continue to erode on the social media front. The newspaper industry will see increased number of advertorials re-packaged as "native advertising" by which companies will pay for advertisements to be written as paid newspaper article.

In India, the BJP government is yet to clarify its position on foreign direct investment in retail. Irrespective of its final decision, retail sales should surge sharply upward there as the consummation of pent-up demand of past few years couples with the thriving of ‘mall culture’ in middle-tier cities. China will also see an increase in retail sales inspite of its investigation in to WalMart. The anti-corruption campaign though will negatively impact luxury good sales as well as those of higher-end automobiles there. A strong dollar will affect US companies with significant operations abroad. Wheat production might match 2014 record volumes in Europe; though more newsprint will probably be devoted to higher prices of cocoa from Ivory Coast. Idiosyncrasies of local markets will shine as Dubai invests in large-scale brick and mortal malls, while Manhattan gets more of its groceries delivered at home steps.
Demand for energy should rise at the same pace as the world GDP next year. Analysts will point at attractive valuations of oil companies. If shale price remains attractive, Sabine Pass in Louisiana will emerge as the first plant in US to export LNG. Four years after the Fukushima incident, Japan will see nuclear reactors back in operation at Sendai.

2014 saw the denizens of the developed world fret about Ebola, breast cancer (through a campaign by actor Angelina Jolie) and ALS (through the ice bucket challenge). Overall, health spending will comfortably outpace the rate of growth of the overall economy. Long-term secular trends driving this are the aging population in the western world (with the population pyramid replaced by a population dome) and an emerging middle class elsewhere with increasing demand for improved access to healthcare. Universal healthcare has been promised for all in India, which should drive up healthcare expenditure by a significant amount there. In 2015, large US companies are mandated under Obama-care to provide insurance to more than 70% of their eligible workforce. Uncertainty on US healthcare reform and debate thereon may cause short-term price volatility. Millennial Development Goals will reviewed by the UN later in the year with a new set of goalposts announced for countries to be met by 2030; different NGOs will campaign vigorously through media to get their pet agendas included in the final list.

Transportation companies will report higher earnings from increased economic activity. Apart from some airlines which have suffered reputation damage through recurring accidents, airline companies will benefit from the reduced oil prices. Defense industry will see robust growth in China, as "Chi-America" remains no more a chimera. Alarmed by this increase, Vietnam with Philippines will move within the US ambit and Australia will seek to join the tripartite naval exercises in the Indian Ocean between US, Japan and India. Tensions in Eastern Europe and the middle-east will favor increases in expenditure across the region. The nationalist government in India will increase defense expenditure sharply even as it moves beyond lip-service on the long-standing issue of indigenization of defense manufacturing.
The mantra of social-local-mobile (SoLoMo in tech jargon) continues to drive the consumer markets division of information technology companies.[92] Expenditure on IT hardware is significantly retarded by the increasing move to cloud computing.[93] The move to cloud computing - along with increasing use of mobile commerce - bodes well for the computer security business.[94] India should see a sharp increase in smart phone adoption; elsewhere tablet computers will rise against laptop and desktops.[95] Embedded systems coupled with rudimentary networking will be marketed as an all-encompassing internet of things as the era of big data continues.[96] Today, a single family in US places more demands on data flow than the entire planet did a decade back; and even this data rate is expected to increase by a whopping 70% over the next year. Consolidation in the cable sector (e.g Comcast with Time Warner Cable) and the convergence of content with distribution (e.g. AT&T with DirectTV) are two trends that should continue on from 2014.[97] Even as Indians will talk about 3G coverage spanning the nation; Americans will tweet about 4G price warfare and the Chinese will see ZTE unveil a 5G prototype.[98] Facebook will have more users than China has human beings.[99] Analysts will harp about impact of interest-rate hikes on high dividend paying telecom stocks.[100] Apart from the financial industry, telecom will emerge as an industry most impacted by federal regulation across the globe.

The anthropologist Edward Weyer once compared the future to being akin to a "corridor into which we can see only through the light coming from behind". It is in that sense that we have analyzed the data of the bygone year and tried to extrapolate into the days and months ahead. And when some are falsified - and falsified, some will be - then we shall lay credit for the same at the feet of those responsible - viz. us, the people.

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Raghuram Rajan is implementing the vision he outlined in 2003 in his book co-authored with L. Zingales titled “Saving capitalism from the capitalists”

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